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Foreign Direct Investment in the United States and Europe

This Essay provides a short primer on the review of foreign direct investment by the Committee on Foreign Investment (CFIUS) in the United States and the potential for significant reform in the US, as well as on developments in Germany and the EU reform initiative. In so doing, this Essay notes some of the connections between and among foreign direct investment review in the US, Germany, and the EU. Changes in the way that foreign direct investment review is conducted in the US and Europe are likely. The following contextualizes those changes by providing an overview of the status quo and identifying the scope of potential reform.

Dieser Beitrag gibt einen Überblick über die Kontrolle ausländischer Direktinvestitionen in den USA durch das Committee on Foreign Investment in the United States (CFIUS), beschreibt das Potenzial für bedeutende Reformen in den USA, die Entwicklungen in Deutschland sowie die EU-Reforminitiative im Bereich Investitionskontrolle. Dabei werden einige Zusammenhänge zwischen der Kontrolle ausländischer Direktinvestitionen in den USA, Deutschland und der EU festgestellt. Änderungen in der Art und Weise, wie die Überprüfung ausländischer Direktinvestitionen in den USA und Europa durchgeführt wird, sind wahrscheinlich. Im Folgenden werden diese Änderungen im Rahmen eines Überblicks über den Status quo und den Umfang möglicher Reformen eingeordnet.

I. Introduction

Domestic review of foreign direct investment has received increased attention lately on both sides of the Atlantic. CFIUS – the interagency committee charged by statute to review certain inbound investments from a "national security" perspective – has in recent years scrutinized a growing number of cases, spent more time investigating the cases within its review, and imposed requirements as a condition of clearing transactions more often.[1] CFIUS has also blocked more transactions recently. And even with this increased activity, many policymakers in the US advocate for a still stronger and more scrutinizing committee, at least for transactions involving investors from "countries of special concern." This view is embodied in new legislation to reform CFIUS pending in the US Congress, which could well pass this year. Meanwhile, Canada recently decided to reject China's Communications Construction Company International Holding's proposed acquisition of Aecon, a large Canadian construction services firm.

In Europe too, several European Union Member States, as well as the EU itself, are reconsidering their approaches to foreign indirect investment. Not least of all, Germany took steps within the last year to increase its oversight of foreign acquisitions in response to greater investment in European, and specifically in German, companies. In addition, in September 2017, the European Commission introduced important draft regulation for screening foreign direct investment in the EU, a draft currently under review and likely to be amended by the European Council and European Parliament. While almost half of the EU Member States have laws authorizing review of foreign direct investment, generally through the lens of "public security," their mechanisms differ in scope and procedure (e.g., ex-ante/ex-post review, voluntary/mandatory notifications, general/sectoral coverage, etc.). Given that divergence, an EU-wide regulation aims at ensuring coordination and cooperation among the Member States.

II. CFIUS: A Primer

In the US, CFIUS – composed of many executive departments with heavy representation from the US intelligence community – has jurisdiction to review "any merger, acquisition, or takeover … by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States."[2] This mission is defined by statute and further specified by implementing regulations promulgated by the US Department of the Treasury. Notably, entities within the US but owned by a foreign entity are subject to CFIUS's jurisdiction, as highlighted below.

CFIUS's process for assessing a covered transaction and resolving any national security threat it may pose involves up to three stages – "review," "investigation," and "presidential decision".[3] CFIUS review can be initiated in the first instance by the parties to a transaction, and it usually is, or instead by the Committee acting on its own. Where the

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1 See generally CFIUS, Annual Report to Congress for CY 2013 (Feb. 2015); CFIUS, Annual Report to Congress for CY 2014 (Feb. 2016); CFIUS, Annual Report to Congress for CY 2015 (Aug. 2017).

2 50 U.S.C. § 4565(a)(3) (2018).

3 50 U.S.C. § 4565(b)(1)(E)-(b)(2)(C); 31 C.F.R. § 800.502(b); § 800.505-06.

parties initiate a review of their transaction voluntarily, they do so by providing a joint "notice" to the Committee. Once formally accepted, that notice starts a 30-day clock for CFIUS to complete the review stage to determine as a threshold matter whether the transaction might impair the national security of the United States. During this initial review, the US Director of National Intelligence undertakes an analysis to assess "any threat to the national security." That threat assessment is classified and thus not shared with the parties.

While CFIUS review focuses centrally on the national security implications of proposed transactions, "national security" is not defined in the CFIUS statute. Instead, the law lists a dozen "factors" that are to inform the Committee's national security review. These factors include, for example, the energy requirements of the US and the security-related effects of a transaction on major energy assets; the control of domestic industries and of commercial activity by foreign persons; the domestic production needed for national defense and the capability of domestic industry to meet the production requirements for the national defense; and the effects on critical infrastructure.[4]

If any component agency member of CFIUS believes that the covered transaction threatens to impair the national security and that the potential threat has not been mitigated during the initial review process, *or* if the Committee concurs in a recommendation by the designated "lead agency" favoring an investigation, then CFIUS moves to the second stage mentioned above – the national security "investigation." A natural security investigation is required, though, whenever a covered transaction would result in the control of a US business or US assets by a foreign government (as opposed to a foreign person). It is required also when a transaction would result in foreign control of US "critical infrastructure" wherever the Committee determines that the acquisition of that critical infrastructure "could" impair the national security and that the potential to impair the national security has not been mitigated during the review stage.

If none of these conditions requiring a national security investigation apply, such as for example when the Committee concludes as a result of the initial review that a transaction poses no potential threat to the national security at all – or else when any such threat has been mitigated by measures the parties to the transaction agree to take – then the Committee may conclude the initial review and notify the parties. That notification in effect constitutes approval of the transaction from a national security perspective, though strictly speaking CFIUS does not affirmatively approve so much as decide not to recommend a block of a transaction. Otherwise, where the second-stage investigation is necessary in order to assess further a potential and yet-unmitigated national security threat, that stage of the investigation must be completed within an additional 45-day period.

Here once again, CFIUS review of a covered transaction may end during this second stage, upon a determination by the Committee that any national security threat has been mitigated by steps the parties to the transaction agree to take in order to have the transaction approved. As this suggests, a crucial part of the CFIUS approval process, at all stages, is the exploration and potential negotiation between CFIUS and the transacting parties of conditions surrounding the transaction (and subsequent business arrangements resulting from the transaction) that would "mitigate" the national security risks sufficient for CFIUS to approve the transaction.

The CFIUS process can be very interactive. During both the initial review period and the subsequent investigation period, the Treasury Department – on behalf of the Committee – often will issue written questions for the parties to answer. The parties have three business days to answer those questions in writing, though the Treasury Department will entertain extensions of the three-day deadline. Especially complicated reviews before CFIUS can generate dozens of rounds of questions. In some cases, it is also necessary for the parties to meet with CFIUS in Washington, D. C. At times, when the Committee may need more time to explore potential mitigation possibilities with the parties, the Committee may request that the parties withdraw their notice and file it anew (a "pull and refile" in CFIUS parlance) to restart the review periods noted above.

Where the Committee determines that mitigation steps – to which the parties to the transaction agree to be bound – are available to minimize threats to the national security, it will then conclude its review and notify the parties that the Committee will take no further action. Again, this notification is tantamount to CFIUS approval. But in the absence of mitigation satisfactory to address national security threats, the Committee will instead recommend that the President "suspend or prohibit" the transaction. The President's consideration of CFIUS's recommendation to suspend or prohibit the transaction, then, constitutes the third and final stage of CFIUS review. Under the CFIUS statute, the President has 15 days to resolve the matter by adopting the Committee's recommendation to stop the transaction, although the President is not obligated to follow such a recommendation.[5] To block a transaction, the President must conclude that there is "credible evidence" the transaction would impair the national security, and that other US laws are inadequate or inappropriate to protect the national security under the given circumstances, findings based on information provided to the President by the Committee. In practice, presidential consideration of transactions is rare, though not unprecedented, given that parties anticipating a negative recommendation to their transaction are inclined to withdraw it rather than subject themselves or the asset in question to the stigma of being blocked.

III. Potential CFIUS Reform

Legislation pending in the US Congress could well bring significant changes this year to these well-established foreign investment practices in the US. Leading bills voted out of committee in the US Senate and House of Representatives (thus pending passage by the full chambers), the Foreign Investment Risk Review Modernization Act (FIRRMA), would provide for variable scrutiny by CFIUS depending on the country of origin of the foreign investor.[6] Indeed, the bill specifically targets, without naming, "countries of special concern"[7] – which the bill's sponsors indicate refers especially to China to be specified by implementing regulation. This variable scrutiny would work both ways, however, which is to say foreign investors from countries with which the US has a mutual defense treaty or a mutual arrangement to safeguard national security with regard to foreign investment – like Germany – would enjoy expedited CFIUS review.

FIRRMA would bring a number of other important changes as well. For example, it would bring still greater scrutiny on

4 50 U.S.C. § 4565(f).
5 50 U.S.C. § 4565(d)(2).
6 E.g., Senate Bill S.2098.
7 E.g., S.2098 § 3(a)(4).

transactions involving "critical technology" and "critical infrastructure." The legislation would also extend CFIUS's jurisdiction to reach some transactions beyond controlling acquisitions, such as certain acquisitions involving real estate near US military installations, and again, transactions involving critical technologies giving a foreign buyer access to nonpublic information. Here again, buyers from certain countries could be exempted from this wider CFIUS scrutiny.

In addition, FIRRMA would expand significantly the criteria CFIUS would consider in evaluating national security risks. Among other new factors, CFIUS would consider the foreign acquirer's cumulative market share of certain assets, the history of the would-be acquirer's compliance with US laws, risks to the protection of personally identifiable information, and the risks of cyber vulnerabilities. In addition, the legislation would extend the time CFIUS has to review a transaction, require filing fees for parties filing a notice, and increase the resources CFIUS has to perform its national security reviews, among other changes.

The exact contours of this reform legislation have yet to take shape. FIRRMA has a US Senate version as well, which differs from the House bill in some of its particulars, but not in its overall approach. Notably, both bills enjoy bipartisan support, and indeed bipartisan sponsorship, as well as support by the current Administration. Such support (rare in the current political climate in the US) is why CFIUS reform legislation may be more likely than not to pass. In fact, the Senate bill was recently appended to must-pass legislation (the National Defense Authorization Act), which further increases its likelihood of passage. The Senate and House versions would require reconciliation to eliminate their differences. But given their similar orientation and approach, it seems reasonable to expect that CFIUS reform legislation will pass this year.

IV. CFIUS Illustrated: US-German Links

Two recent CFIUS cases that happen to involve German-based companies illustrate how consequential CFIUS can be – quite apart from CFIUS's obvious relevance to potential acquirers – beyond US borders. One such example involved China's Grand Chip Investment Fund LP's announced acquisition of Germany's Aixtron SE for some €670 million (US $752 million).[8] Reportedly, Aixtron manufactures equipment used in the production of semiconductor devices, using technology with military applications.[9] Because Aixtron has subsidiaries in the US, the transaction was subject to CFIUS's jurisdiction, at least insofar as to Aixtron's presence in the US. The parties thus sought CFIUS review voluntarily by submitting a joint notice to the US Treasury Department.

Following several months of such review, CFIUS ultimately referred the matter to President Obama, who issued an order blocking the transaction in December 2016. This marked only the third time that a President had blocked a transaction outright since CFIUS was formally established as a statutory body in 2007. What is more, the order blocking the transaction by its terms extended extra-territorially: It blocked the sale not just of assets and subsidiaries within US borders, but also the sale of "any assets of [Aixtron] used in, or owned for the use in or benefit of, the activities in interstate commerce in the United States."[10] The breadth of this prohibition made restructuring the proposed acquisition infeasible. The parties thus subsequently abandoned the transaction.

There is more to the Aixtron example, however. While the transaction did not raise concerns in Germany initially, in October 2016, the Ministry of Economic Affairs and Energy (BMWi) withdrew and reopened its previous clearance.[11] According to press reports, that reconsideration was prompted by concerns expressed by the US government that the transaction could result in access to sensitive military technology by China. In short, CFIUS review seems to have informed Germany's review and assessment of the same transaction.

For another illustration, the China-based Creat Group announced in April 2017 its intended takeover of Germany's Biotest AG €1.3 billion (US $1.5 billion). Biotest AG develops products and services to treat blood coagulation disorders, autoimmune disease, and other immune deficiencies. The company has a US subsidiary, Biotest Pharmaceutical Corporation, included in the proposed takeover, thus triggering CFIUS's jurisdiction just as Aixtron's US subsidiaries brought that deal within CFIUS's purview. Accordingly, the parties sought CFIUS clearance, following the processes summarized above.

According to media reports, CFIUS took a hard look at the proposed transaction, focusing on Creat's activities in the technology sector generally and no less on the volume of personal identifying information (PII) and patient health information (PHI) that Biotest maintained for US citizens. While CFIUS's deliberations are not disclosed publically, it is apparent that, for some reason or another, the proposed transaction did not clear during the initial 30-day review period or the following 45-day national security investigation period. In November 2017, then, the parties withdrew their filing, reportedly with an intent to refile and thus to restart the CFIUS clock to give the Committee more time.

Subsequently, however, they restructured the transaction altogether: In January 2018, Biotest AG announced that it had sold its US operations, Biotest Pharmaceutical Corp., to a third party that according to media reports did not raise the same level of concern for CFIUS. Once Biotest Pharmaceutical Corp. was no longer a component of Creat's acquisition of Biotest AG (and given that Biotest AG had no other US subsidiary), the transaction no longer fell within CFIUS's jurisdiction. At the very end of January 2018, Biotest AG announced that CFIUS had cleared the transaction and Creat's takeover of Biotest AG then closed.[12]

8 *GCI to Launch Offer for Aixtron SE*, Aixtron (May 23, 2016), https://www.aixtron.com/fileadmin/user_ upload/IR/2016/160523_Press_Release_EN_final.pdf.

9 E.g., *U.S. Warned Berlin on China-Aixtron Deal: Handelsblatt*, Reuters (Oct. 26, 2016, 6:49 AM), https://www.reuters.com/article/us-aixtron-m-a-fujian-usa-idUSKCN12Q1A0.

10 Regarding the Proposed Acquisition of a Controlling Interest in Aixtron SE by Grand Chip Investment GmbH, 81 Fed. Reg. 88,607 (Dec. 2, 2016). *See also* David McLaughlin, *Obama Blocks Chinese Takeover of Aixtron as U.S. Security Risk*, Bloomberg (Dec. 2, 2016 5:01 PM), https://www.bloomberg.com/news/articles/2016-12-02/obama-blocks-chinese-takeover-of-aixtron-as-u-s-security-risk.

11 Withdrawal of Clearance Certificate and Reopening of Review Proceedings by the Ministry of Economics Pertaining to the Takeover by Grand Chip Investment GmbH, Aixtron (Oct. 24, 2016), https://www.aixtron.com/ en/investors/financial-news/archive-2015/detail/?tx_news_pi1 %5Bnews%5D=2634&cHash=cb08e474ae0e037985 8380c9cb08214 c.

12 *Biotest Sheds U.S. Business to Allay U.S. Concerns of Chinese Takeover*, Reuters (Jan. 19, 2018 2:20 PM), https://www.reuters.com/article/us-biotest-m-a-creat/biotest-sheds-u-s-business-to-allay-u-s-concerns-of-chinese-takeover-idUSKBN1F82FC. *See also Creat Takeover of Biotest Closed*, Biotest (Jan. 31, 2018, 6:00 PM), https://www.biotest.com/de/en/investor_ elations/news_and_publications/biotest_press_releases/press_detail.cfm?instance_ID=2768&cmfaction=xmldetail.xmldetail.detailview&showdetails=1671693.

V. Foreign Direct Investment in Germany

Foreign direct investment review has also taken on heightened significance, and spawned regulatory change, beyond the US. In Germany, the Foreign Trade and Payments Ordinance (FTPO) was amended last year to broaden review of non-EU investments in German corporations. Previously, non-EU investors were under no affirmative requirement to notify the German government of a planned acquisition of a German business unless the target company developed or manufactured certain defense-related products or encryption technology. Non-EU acquisitions were nevertheless reviewable by the BMWi for three months following an acquisition, and non-EU buyers could request a certificate of non-objection from BMWi prior to closing their transaction in order to avoid the legal uncertainty associated with the possibility of such *ex post* BMWi review, much as parties may seek clearance with CFIUS for analogous reasons, as explained above.

Following recent changes to the FTPO, however, now potential acquirers are obligated to notify the BMWi of proposed transactions involving non-EU investment in either critical infrastructure or security-related technologies wherever the would-be acquirer would have 25 % or more of the voting rights of the German company, even if indirectly. The amended FTPO further provides for longer review periods for BMWi consideration (which, as a result, are no longer aligned with the review periods for German merger control proceedings). Upon now-required notification, the BMWi will consider whether the proposed transaction poses a threat to "public order or security." And following review – if BMWi elects to undertake formal review following notice – it, like CFIUS, can issue conditions for a transaction or prohibit a transaction for reasons of public security.

For transactions where notice is still not obligatory, the BMWi has jurisdiction to review any non-EU investment within three months of its knowledge of the signing (with a five-year limitation). Parties may continue to request from BMWi its non-objection for such a transaction. BMWi might then issue a certificate of non-objection on which the parties may rely, which certificate is also deemed to issue after two months if BMWi has not in fact raised potential objections. Otherwise, any time within the two-month period, BMWi may open an in-depth review, a decision point comparable to CFIUS's decision to undertake a national security investigation following its initial review of a transaction.

VI. The Draft EU Proposal

At present, foreign investment is not subject to regulation at the EU level. But in September 2017, the European Commission also instigated reform in a way that could have significant consequences for Member States (and their foreign investors) by proposing a regulation for screening foreign direct investment across the EU.[13] This proposal follows the Commission's May 2017 "Reflection Paper on Harnessing Globalization," which raised concerns about foreign investment in Europe – in particular, by state-controlled investors from countries that do not reciprocate the EU's open investment regime – targeting certain EU technologies. The EU proposal would thus establish a general framework, aimed largely at coordinating the foreign investment control regimes at the Member State level, and between states that have review mechanisms and the EU.

For example, the EU proposal would invite the Member States to "adopt, maintain or amend" their existing review mechanisms and anti-circumvention provisions. The latter are designed to identify foreign investments made through EU-established entities in order to avoid foreign investment review by countries that exempt EU investors or treat them more favorably. The EU proposal provides a non-exhaustive list of criteria Member States should consider taking into account when conducting foreign investment reviews, very much like those used in both the US and Germany, including a transaction's effects on critical infrastructure, advanced technology, the security of information, the supply of critical inputs, and so on. The EU proposal further suggests that the Member States take special cognizance of transactions involving investors controlled by foreign governments.

With respect to intergovernmental coordination, the Member States would inform one another, as well as the European Commission, within five days of initiating review[14] if a review is also likely to fall within the scope of the EU Merger Control Regulation. Interestingly, non-reviewing states that believe their own security or public order would be affected by a given transaction could provide comments to the reviewing state. In such circumstances, or if the investment might affect security or public order in more than one other Member State, the European Commission itself could provide comments or issue an opinion on the transaction.[15] That opinion would not be binding on the reviewing state, but would nevertheless provide a mechanism for registering potential multi-state implications of a given transaction. The EU proposal thus would give the European Commission itself a role in foreign investment review.

The EU proposal is currently being reviewed by the European Council and the European Parliament. It may be amended to enable the Member States and the European Commission also to check, among other factors, whether a foreign investment might affect media independence or the EU's strategic autonomy, whether the investor has a track-record of investing in projects that might threaten security or public order, and whether the investment could lead to the creation of a monopoly.

VII. Conclusion

It remains to be seen just how integrated foreign direct investment review will become within the EU. But the European Commission's initiative highlights the increased attention that foreign investment now commands, both within and beyond Europe. And whether or not the European Commission's proposal is adopted, informal coordination between and among reviewing states seems inevitable. Given many countries' increasing focus on the potential national-security implications of foreign investment, and moreover given the multi-jurisdictional implications of many transactions, especially those involving investment targets with a presence in many countries – as the Aixtron and Biotest cases well illustrate – it stands to reason that countries like the US, Germany, and others will continue to strengthen and reform, and to coordinate, their investment review regimes. ■

13 *See* Proposal for a Regulation of the European Parliament of the Council establishing a framework for screening of foreign direct investments into the European Union of 13 September 2019, COM (2017) 487 final (EU proposal).
14 Art. 8 of the EU proposal.
15 Art. 9 of the EU proposal.